



Audit Report



OIG-04-028

REVENUE COLLECTION AND INDUSTRY REGULATION: Alcohol and Tobacco Export Controls Strengthened, But More Action Is Needed

February 26, 2004

Office of
Inspector General
Department of the Treasury

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Abbreviations

ATF	Bureau of Alcohol, Tobacco and Firearms
CFR	Code of Federal Regulations
CY	Calendar Year
DSP	Distilled Spirits Plant
FY	Fiscal Year
JAMES	Joint Audit Management Enterprise System
NPA	Notice of Proposed Assessment
NPRM	Notice of Proposed Rulemaking
NRC	National Revenue Center

Contents

OIG	Office of Inspector General
TTB	Alcohol and Tobacco Tax and Trade Bureau



Audit Report

*The Department of the Treasury
Office of Inspector General*

February 26, 2004

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Alcohol and Tobacco Tax and Trade Bureau

We conducted a follow-up audit of the Alcohol and Tobacco Tax and Trade Bureau's (TTB)¹ controls over exported distilled spirits and tobacco. When exported, these products may be exempt from Federal excise tax. To ensure the tax exclusions are proper, TTB monitors distilled spirits plants (DSP), tobacco plants, and export warehouses through technical services and revenue inspections.

We conducted this follow-up audit as part of our Fiscal Year (FY) 2002 *Annual Plan*. Our primary objective was to determine whether the former Bureau of Alcohol, Tobacco and Firearms (ATF) had taken corrective action to address recommendations contained in two previously issued reports: (1) *Bureau of Alcohol, Tobacco and Firearms Controls Over Tax Free Spirit Exports* (OIG-99-123, September 15, 1999), and (2) *The Bureau of Alcohol, Tobacco and Firearms Needs to Improve its Controls Over Tax-Free Tobacco*

¹ At the time of our fieldwork, the entity audited was the Alcohol and Tobacco Directorate under the Bureau of Alcohol, Tobacco and Firearms (ATF). On January 24, 2003, ATF was transferred from the Department of the Treasury to the Department of Justice; however, the Alcohol and Tobacco Directorate remained with Treasury and is now known as the Alcohol and Tobacco Tax and Trade Bureau (TTB). When referring to the prior reports or actions, we use ATF to identify the bureau. When referring to current issues, we refer to the bureau as TTB.

Exports (OIG-01-019, November 13, 2000). These earlier audits had found:

- inadequate (or no) documentation to support the exportation and subsequent tax-free status of products;
- inadequate controls over export tracking logs that allowed a large number of shipments with substantial potential tax liability to remain open and unresolved for years; and
- no routine third-party verifications either during on-site inspections or through off-site monitoring to ensure that shipments were actually exported.

Contributing to these control weaknesses were unclear regulatory guidance, resource constraints, and clerical unfamiliarity with export documents.

We conducted our audit fieldwork from April 2002 to April 2003 at TTB Headquarters in Washington, D.C., and the National Revenue Center (NRC) in Cincinnati, OH. A more detailed description of the audit objective, scope, and methodology is provided in Appendix 1.

Results in Brief

ATF took corrective actions to address several of the factors contributing to the problems of inadequate documentation and weak controls. ATF made changes to regulatory guidance, training, and supervision; drafted (but did not finalize) a proposed change to Section 27 of the Code of Federal Regulations (CFR) to require acceptable proof of export be received within 90 days of product exportation; finalized an industry circular that provides guidance on the documentation required to support exportation; held several training sessions; and increased supervisory review.

However, ATF did not completely address the problems with missing or incomplete records needed to support the tax-free status of alcohol and tobacco exports, controls over export tracking logs, and third-party verifications of exports.

First, concerning the shipments for which documentation was inadequate or non-existent during our original audits, ATF reviewed the shipments and requested manufacturing companies to submit documentation to prove exportation occurred. This effort resulted in submission of many documents, but we continue to have concerns. For example, we had recommended that the ATF Director send tax assessment letters covering shipments for which the DSPs had not submitted any documents to support the claimed exports. Instead, an NRC official said DSPs had been notified of the need for documentation, and adequate proof of exportation had been received. We selected a sample of these distilled spirits and tobacco products records to review. NRC personnel were unable to locate 10 of 65 DSP records we originally requested and one record did not have adequate proof of exportation. NRC personnel said that the missing records might have been sent to imaging for electronic copying. For tobacco records, NRC was unable to locate 5 of 34 records we requested. An NRC supervisor said the missing records were in the database in error. We recommend that TTB require the NRC to maintain better control of its alcohol and tobacco tax-free export records. We also recommend that TTB ensure adequate proof of exportation is obtained for all exports.

Second, we had recommended in the prior audits that ATF resolve the status of open shipments listed in export tracking logs.² Although ATF indicated these logs were reviewed, ATF's NRC personnel were unable to provide sufficient data to support that all of the reviews were actually performed. Accordingly, we could not determine whether ATF fully addressed the intent of the associated recommendations. We performed limited testing of open export shipments for Calendar Year (CY) 2002 to determine whether ATF appropriately reviewed the export shipments for evidence of exportation and found open tobacco shipments without evidence of exportation received within 90 days of the claimed shipment date. In addition, ATF did not issue Notices of Proposed Assessment

² NRC specialists use export tracking logs to keep track of export shipments and to ensure shipment files remain open until adequate export evidence is received. Sometimes these logs are also referred to as "pending files."

(NPA) as required in ATF Order 5020.8B (a revised version of ATF Order 5020.8A).

As a result, we are recommending that TTB develop an automated tracking system to allow exporters to electronically submit information on exports and allow TTB to better track the status of open shipments. An automated tracking system should help TTB avoid having shipments remain open for lengthy periods, such as a year or more that we found during prior audits.

Third, we had recommended that the ATF Director assess increasing the use of third-party verifications. We found that the use of third-party verification letters, initiated in response to recommendations in both audit reports, was tried but apparently terminated because ATF could not find a way to provide postage for return mail. Other means may be available to obtain such verification. We recommend that TTB find a way to re-assess the use of third-party verifications.

In response to our draft report, your office indicated that the best approach for handling the deficiencies we identified is a complete revision of the process for managing tax-free exports. Rather than having documents routinely submitted to the NRC, TTB would adopt a post-audit process in which exports would be validated at the manufacturers. TTB plans to develop post-audit procedures that require the manufacturers to maintain export documentation on premises for review by TTB auditors and investigators. If properly implemented, we believe this post-audit approach meets the intent of our recommendations. However, TTB did not provide its detailed plan and estimated completion date to finalize and implement the new post-audit procedures. Pursuant to Treasury Directive 40-01, *Responsibilities of and to the Inspector General*, we request that you provide this information to our office within 30 days of the date of this report. TTB's complete response is included as Appendix 3.

Background

On September 15, 1999, we issued a report entitled *Bureau of Alcohol, Tobacco and Firearms Controls Over Tax Free Spirit Exports* (OIG-99-123). The audit found that certain management controls over the tax-free exports of distilled spirits products needed greater attention. Specifically, adequate proof of exportation was missing in files or unavailable to ATF even though exportation was the basis for waiving millions of dollars in excise taxes. We estimated that ATF could assess at least \$66.6 million of taxes on shipments that had improper or no exportation evidence. Also, we reported that ATF had not closed claimed export shipments with associated taxes of \$560 million for 1996 and 1997.

On November 13, 2000, we issued a second report entitled *The Bureau of Alcohol, Tobacco and Firearms Needs to Improve its Controls Over Tax-Free Tobacco Exports* (OIG-01-019). This audit reviewed the same issues as the report described above, only this time for tobacco products. The audit found that increased oversight was also needed over ATF's processing of tax-free shipments of exported tobacco products. We estimated that ATF may be able to assess at least \$86.9 million of taxes on shipments where export documentation was inadequate or nonexistent.

The audit reports contained 15 recommendations, including 7 for the DSP report and 8 for the tobacco report. ATF closed all recommendations except those related to 27 CFR and the automated system in the Joint Audit Management Enterprise System (JAMES). The open recommendations advised ATF to (1) amend 27 CFR to include specific time frames for DSPs to submit documents that support claimed exports and additional guidance defining adequate export evidence (the completion date for this recommendation was August 13, 2003), and (2) establish controls to ensure Tobacco Unit specialists properly monitor open shipments listed in the tracking logs (the completion date for this recommendation was October 1, 2003). As part of the second

recommendation, we recommended ATF consider automating the process for submitting and verifying export notifications.

Although these recommendations remain open in JAMES, ATF had planned actions that, if taken, would have closed out the recommendations. First, ATF proposed a regulation to include specific time frames for DSPs to submit export documents. TTB needs to finalize the regulation. Second, although ATF developed controls to help ensure Tobacco Unit specialists monitored open tracking logs, the funding for an automated tracking system has not been available. We believe TTB should continue to pursue the development of an automated system.

Findings

Finding 1 Actions Were Taken To Improve Guidance, Training, and Supervision

In our prior audits, we found that a combination of factors contributed to control weaknesses that allowed exportation of distilled spirits and tobacco products, and the waiving of excise taxes, without sufficient documentation on file to validate that exportation actually occurred. These factors included transitional effects, including resource constraints and records control, associated with a reorganization of five regional technical services offices to the NRC in Cincinnati (which was recent at the time of those audits); unclear regulatory and internal guidance over specific documentation requirements; clerical staff unfamiliarity with requirements; and the lack of enforcement action and sanctions (i.e. ATF had not sent tax assessment letters when documentation was lacking).

During our follow-up audit, we found improvements in the following areas.

- ATF issued an industry circular in July 2002 to provide guidance on adequate proof of export. ATF also drafted a

regulatory change to 27 CFR in September 2002 that included a requirement for proof of export to be submitted within 90 days of export. At the time of our audit, however, this regulation still needed to be finalized.

- ATF issued ATF Order 5020.8B, a revision of ATF Order 5020.8A, which provided guidance on processing exports.
- According to an NRC supervisor, the NRC held four training sessions for technical service clerks responsible for reviewing submitted documentation as evidence of exportation. Although we could not find documented evidence that these classes were held, an Office of Inspector General (OIG) auditor attended a later session and found it informative. In addition, an NRC supervisor said that supervisor and employee meetings were held to discuss proof of export documentation requirements, and newly-hired specialists were assigned to work with other specialists until they became proficient.
- The NRC took steps to ensure supervisory review of specialists' work. This included annually sampling and reviewing specialists' work, and including the findings in annual performance appraisals.

Despite these improvements, we found that records control and the lack of documentation continued to be a problem at the NRC in Cincinnati. We also found a need to more timely obtain and review documentation supporting exportation. This is discussed in detail in Findings 2 and 3 below.

Finding 2 Locating Records Was A Problem

Our previous audits of alcohol and tobacco exports found that ATF was unable to locate records to support the tax-free status of specific shipments. Although an NRC supervisor told us during our current audit that records were obtained for these exports, we found that in certain cases the records could not be located.

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- For the prior audit of DSPs, we found no documentation supporting 194 shipments with potential excise tax liability of \$4.6 million. ATF personnel said documentation was received on all but one shipment. We selected a sample of 20 shipments and NRC could not locate records for 5. We substituted 5 others and found that 17 shipments had adequate documentation and 3 did not.
 - Again for the prior DSP audit, we found inadequate documentation supporting 449 shipments with a potential tax excise value of \$62 million. ATF conducted an inspection to address 24 of the shipments and performed additional review for the remaining 425. An NRC official said adequate proof of export had been received for all shipments. During our follow-up audit, we selected 45 of the original 449 shipments for review, but NRC could not locate 5 of the records. When NRC could not locate these records, we substituted five others. We requested the documentation that supported the exportation to verify the adequacy of it. Although we verified the documentation for 44 of the shipments, 1 shipment did not have adequate documentation.
 - For the audit of tobacco shipments, we requested files for 34 of 82 shipments previously lacking records to support the exportations. ATF could not locate 5 of the 34 files. The files were listed on ATF's database under an export warehouse number that had been out of business since 1961. The Tobacco Unit supervisor attributed this problem to a data error because the export shipments should have been entered under the permit number for the tobacco producer, rather than the export warehouse. When these records could not be located, we again substituted five others.

We believe that sound records management is an essential internal control. The Comptroller General's *Standards for Internal Control in the Federal Government* requires organizations to establish effective internal controls to prevent and detect errors and possible fraud. The inability of ATF to properly retrieve records indicated a

weakness in the internal controls over essential government records.

In summary, of the original 65 DSP records we requested during our follow-up work, NRC could not locate 10. Also, for the 34 tobacco shipment records we requested, NRC could not locate 5. We believe that the inability to locate these records, especially with possible tax liability at stake, is a problem that needs to be addressed. It also raises questions about whether (1) all appropriate documents supporting exportation were submitted and reviewed by ATF, and (2) all excise tax waivers claimed by manufacturers were appropriate.

Finding 3 Documentation Was Limited To Support Reviews Of Export Tracking Logs

In our prior audit of DSP tax-free exports, we found 3,649 open export shipments in the export tracking logs that exceeded \$560 million. We recommended that ATF reconcile these items to determine if the DSPs had submitted adequate export evidence. We further recommended that, if adequate export evidence had not been submitted, ATF should initiate action to assess and collect the taxes and any applicable interest and penalties before the 3-year statute of limitations expired. Similarly, in our prior audit of tax-free tobacco exports, we found 25,548 open shipments in the export tracking logs valued at \$59 million. We recommended that ATF reconcile these items to determine if the tobacco manufacturers and export warehouses had submitted adequate evidence of exportation.

In response to the findings of our earlier audits, ATF told us they were working on the resolution of open shipments for both DSP and tobacco products. Although ATF informed us during our follow-up audit that reviews occurred, documentation was limited to support that action had been taken to account for and clear these open shipments. ATF provided only summary documents.

ATF could not provide more detailed documentation showing the results of this work.

- For the DSP exports, ATF provided a summary document that indicated that 13 DSPs were issued NPAs for 107 shipments. This document indicated that ATF collected \$98,422 from 2 of the 13 DSPs and cleared the remaining 11.
- For the tobacco exports, ATF provided a summary document in February 2003 that indicated ATF closed 20,100 of the 25,548 open shipments. Of the 5,448 shipments still unresolved, 3,200 were for CY 1997 and 2,248 were for CY 1998. ATF did not issue NPAs for the shipments in 1997 because the 3-year statute of limitations expired. An NRC supervisor said that NRC had sent inquiry letters requesting documentation and had received some documentary support. For the 1998 shipments, ATF processed NPAs; however, detailed documentation was not available to indicate how the NPAs were resolved.

As part of its Notice of Proposed Rulemaking (NPRM), ATF said it would include a provision for DSPs to maintain export documentation on-site, with a requirement that they submit monthly summaries of all export shipments outstanding and cleared during the month. Using these two summaries, TTB officials believe they would be able to determine which shipments were 90 days old, and would then be able to initiate an NPA letter for those shipments over 90 days old.

In addition to recommending that the open shipments be reconciled, we also had recommended that the ATF Director identify ways to change the current tax-free exportation procedures. We had concluded ATF should explore ways to reduce its paper and manual procedures and automate the process for submitting and verifying export notifications. According to ATF's Deputy Chief, Regulations Division, during the last three budget cycles, ATF did not obtain the funding needed for the development

of an automated system that would allow DSPs to electronically submit export documentation to NRC.

We continue to believe that an automated system would improve controls over the tax-free export process. During our prior audits, we found that ATF did not conduct timely reviews of documentation supporting distilled spirits and tobacco products exports. As part of our follow-up audit, we found that ATF's reviews of open shipments were also not always timely.

For example, in the first quarter of CY 2003 we selected a sample of 28 open DSP exports from CY 2002 export shipments. We found that 14 of the 28 open DSP shipments had documentation on file to support the exportation. However, the NRC specialists did not close 11 of the 14 DSP shipments until 7 to 12 months later. Similarly, we also selected a sample of 28 open CY 2002 tobacco export shipments.³ We found that 11 of the 28 open shipments did not have adequate documentation, though we were told the specialists had requested the information from the manufacturers and export warehouses. These shipments had all occurred more than 90 days before our review.

As previously noted, ATF Order 5020.8B requires ATF to issue NPAs for the open tobacco shipments when evidence of exportation has not been received within 90 days of the claimed shipment date. However, although the open shipments we reviewed were over 90 days old, we found the NPAs were not issued.

We believe an automated export tracking system could help TTB track open shipment records and alert the specialists to shipments that still require documentation supporting the exportation.

³ The samples were judgmentally selected. We did not attempt to use statistically valid and projectable sample sizes. In addition, we also selected 28 DSP and 28 tobacco export closed shipments, but generally found documentation had been received. In one case, we found a DSP shipment closed that should have remained open because adequate documentation had not been received.

Finding 4

More Could Have Been Done To Ensure Use Of Third-Party Verifications

In our prior audits, we found very limited use of third-party verifications of exports. We concluded at the time that this was an important control that would help assure the authenticity of export documents and other pertinent information. In our DSP report, for example, we cited a diversion case that was only discovered when Canadian police informed ATF of suspicious distilled spirits products they had found in Canada. Export documents that ATF had on file were fraudulently prepared and an ATF review of the documents alone would not have identified the diversion.

In response to recommendations in both of our earlier audit reports concerning the need for this control, ATF agreed to use third-party verification letters. In January 2000, the NRC mailed three third-party verification letters to customers that purchased distilled spirits. Similarly, from September 2000 to March 2001, the NRC Tobacco Unit supervisor told us that NRC mailed four letters to purchasers of tobacco products. The letters provided the company name, date of shipment, product description, and quantity. The letters instructed the customers to answer questions concerning the shipments, including the quantity involved and the date received.

NRC supervisors said responses were received on two of the three distilled spirit letters, and two of the four tobacco letters. However, the NRC Chief said these letters were discontinued in March 2001 because ATF could not provide postage for return mail. No other letters were sent.

We believe TTB can do more to ensure the successful use of third-party verification. As we stated in an earlier report, third-party verifications can validate the authenticity of export documents and other information. These verifications may include such steps as contacting (1) foreign customers who purchased alcohol and tobacco from United States companies, (2) the steamship company to review carrier manifests, (3) the Customs

bonded warehouse or the foreign trade zone to authenticate signed 5100.11 forms, or (4) the United States consulate to verify that the consignee name and address are legitimate.

Recommendations

Recommendation 1

We recommend the Administrator of the Alcohol and Tobacco Tax and Trade Bureau require NRC personnel to maintain better control over alcohol and tobacco tax-free export records, and ensure adequate proof of exportation is obtained for all exports.

Recommendation 2

We recommend the Administrator of the Alcohol and Tobacco Tax and Trade Bureau develop an automated system to allow companies to electronically submit required export documentation and to allow the bureau to track export documentation status.

Recommendation 3

We recommend the Administrator of the Alcohol and Tobacco Tax and Trade Bureau re-assess the use of third-party verification.

Management Comment

TTB plans a new approach to ensuring the tax-free status of alcohol and tobacco exports. TTB does not concur with implementing the above three recommendations. Since becoming a separate bureau, TTB has reviewed export verification and determined that it would be best to require manufacturers to maintain export records at their premises and rely on post-audit reviews to verify exportation. TTB's Audit Division has been assigned the development of new post-audit procedures. These records will be available on-site for TTB auditors and investigators. As a result, manufacturers will no longer need to submit export documentation to TTB.

OIG Comment

We concur with TTB's assessment that the current process of verifying tax-free exports has not been working. We believe the new approach could strengthen the verification process and addresses the intent of our recommendations. Accordingly, we consider these recommendations to have a management decision with final action not yet completed. However, we did not receive TTB's targeted completion date for developing and implementing the post-audit review procedures. At a future date, we will verify that the new process has been implemented and assess how well it is working.

* * * * *

We appreciate the courtesies and cooperation extended to our staff during the audit. If you have any questions, please contact me at (617) 223-8640. Major contributors to this report are listed in Appendix 4.

/s/
Donald P. Benson
Director
Eastern Field Audit Office

The overall objective of our audit was to determine whether the former Bureau of Alcohol, Tobacco and Firearms (ATF) implemented corrective actions to address the recommendations contained in our prior audit reports entitled: *Bureau of Alcohol, Tobacco and Firearms Controls Over Tax Free Spirit Exports* (OIG-99-123), issued September 15, 1999; and *The Bureau of Alcohol, Tobacco and Firearms Needs to Improve its Controls Over Tax Free Tobacco Exports* (OIG-01-019), issued November 13, 2000. Since the January 2003 transfer of most of ATF to the Department of Justice, Federal excise tax collection from alcohol and tobacco products has become the responsibility of the Treasury Alcohol and Tobacco Tax and Trade Bureau (TTB).

To ensure adequate proof of export was obtained, we judgmentally sampled both open and closed export shipments of distilled spirits and tobacco products. Similar to our initial audits, we examined export documents such as ocean bills of lading, certificates of receipt, and notices of removal. We also reviewed Notice of Proposed Assessment letters sent by the bureau to companies as a result of our initial audit.

We interviewed the Chief, National Revenue Center (NRC), located in Cincinnati, OH, and other program management staff to obtain background information and an overview of work performed on prior audit report recommendations. We interviewed the Chief, NRC; the Supervisors of the NRC's Distilled Spirits Plant (DSP) and Tobacco Units; NRC Program Managers; and Policy Programs and Coordination staff in ATF (now TTB) Headquarters.

We contacted the Staff Chief, Office of Inspection, regarding the Staff Chief's role in monitoring Office of Inspector General recommendations. We obtained and reviewed the information the Staff Chief maintained on the two prior audit reports. We also interviewed the Deputy Chief, Regulations Division, to obtain information about revisions to the Code of Federal Regulations (CFR) and plans to automate processes for submitting and tracking export notifications.

We reviewed revisions to 27 CFR, Part 252, and ATF Order 5020.8A (revised as ATF Order 5020.8B) to determine if the revised sections met requirements set forth in the prior audit's recommendations. We also obtained and reviewed Joint Audit Management Enterprise System (JAMES) reports for the prior audit reports to determine the status (open or closed) of the recommendations.

In addition, we judgmentally selected, based on our available resources, a sample of 23 companies that had open tobacco shipments during our earlier audit. We then obtained from the NRC the tracking logs for those 23 companies as of March 18, 2003. The tracking logs are summary records of exported tobacco products that indicate whether the file is still open or has been closed. We compared the current tracking logs with the tracking logs we obtained during the initial audit to determine file status.

To determine if problems found in the original two audits were still occurring more than a year after the tobacco products report was issued, we performed limited testing of export shipments in CY 2002. We selected four DSPs, four tobacco plants, and four export warehouses. For the four DSPs, we examined 56 export alcohol shipments, of which 28 were open and 28 were closed. For the four tobacco plants and four export warehouses, we examined 56 export tobacco shipments, of which 28 were open and 28 were closed. For the closed shipments, we wanted to determine whether the proof of exportation was adequate. For the open shipments, we wanted to ensure that the specialists appropriately reviewed the open shipments. We examined ocean bills of lading, certificates of receipt, notices of removal, and other export documents.

We conducted our audit fieldwork between April 2002 and April 2003 in accordance with generally accepted government auditing standards.

Appendix 2
Summary, Status, Action Taken, And OIG Evaluation Of Prior Report
Recommendations

Report: *Bureau of Alcohol, Tobacco and Firearms Controls Over Tax Free Spirit Exports* (OIG-99-123, September 15, 1999).

The audit of tax-free spirit exports identified three deficiencies. First, because export shipments either had improper or no export evidence, we estimated that ATF could assess at least \$66.6 million of taxes. Second, ATF had not closed claimed export shipments with associated taxes of \$560 million. Third, we concluded that ATF needed to conduct more third-party verifications of exported shipments.⁴

For each of the prior audit's recommendations, we assessed the corrective action taken and evaluated whether the action met the intent of our recommendation. The following table summarizes the status and action by recommendation.

Recommendation Summary	Status	Action Taken	OIG Evaluation
1. (a) The ATF Director should send tax assessment letters for the \$4.6 million, plus interest, covering the 194 shipments for which DSPs had not submitted any documents to support the claimed exports.	Closed	ATF received documentation for 119 of the 194 shipments. ATF took corrective action for the remaining 53, which included issuing NPAs in the amount of \$746,232, plus interest.	We selected 20 of the 194 shipments for review. ATF could not locate documentation for 5 shipments. We selected an additional 5 shipments. We found 17 of the 25 total records selected had adequate support.

⁴ Third-party verifications may include such steps as contacting (1) companies in foreign countries who purchased alcohol and tobacco from United States companies, (2) the steamship company to review a carrier's manifest, (3) the Customs bonded warehouse or the foreign trade zone to authenticate signed 5100.11's, or (4) United States consulates to verify that the consignee name and address are legitimate.

Appendix 2
Summary, Status, Action Taken, And OIG Evaluation Of Prior Report
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Recommendation Summary	Status	Action Taken	OIG Evaluation
1. (b) The ATF Director should send tax assessment letters for the \$62 million, plus interest, covering the 449 shipments for which DSPs had submitted inadequate documentation.	Closed	ATF inspected one DSP covering 24 of the 449 shipments. ATF issued NPA letters on the remaining 425 shipments. ATF said adequate documentation was received for all but one shipment. ATF collected \$4,146 on the one shipment.	We selected 45 of the 449 shipments for review. ATF could not locate five records, so we substituted five others. We found that 44 had adequate support, while one shipment did not.
2. The ATF Director should reassess whether 113 shipments with technical non-compliance documentation problems should also be subject to an assessment letter.	Closed	ATF reviewed the 113 shipments and accepted the documentation available as adequate support for export.	We did not see evidence that ATF had reviewed the shipments, but accept that the issues may not be substantive, as ATF concluded.
3. (a) The ATF Director should amend 27 CFR to include specific time frames for DSPs to submit documents that support claimed exports.	Open	ATF proposed amending 27 CFR to include a requirement that acceptable proof of export be submitted to ATF within 90 days of export.	An ATF official said that the Director signed the draft version of this change in September 2002, but the regulation had not been finalized.
3. (b) The ATF Director should amend 27 CFR to include additional guidance defining adequate export evidence.	Open	ATF issued an industry circular in July 2000 to provide guidance on adequate proof of export.	The circular appears to adequately address the intent of the recommendation.
4. (a) The ATF Director should reassess the adequacy of ATF Order 5020.8A, which includes information on the processing of exports.	Closed	ATF has revised the Order dealing with export shipments. ATF said revised sections of the Order dealing with exports were provided to NRC specialists in July 2000.	The revision appears to adequately address the intent of the recommendation.
4. (b) The ATF Director should reassess training for the technical services clerks responsible for reviewing submitted documentation evidencing claimed exports.	Closed	The NRC has held four training sessions since the OIG report was issued in September 1999.	NRC provided a list of attendees at the earlier training sessions. In June 2002, NRC held another training session. An OIG auditor attended the session and found it informative.

Appendix 2
Summary, Status, Action Taken, And OIG Evaluation Of Prior Report
Recommendations

Recommendation Summary	Status	Action Taken	OIG Evaluation
5. The ATF Director should instruct the NRC to reconcile the \$560 million in open items in the tax-free export logs to determine if the DSPs have submitted adequate evidence of export. If not, ATF should initiate action to assess the taxes before the 3-year statute of limitation expires, then collect taxes, interest, and penalties on the distilled spirits exports.	Closed	ATF said the shipments were reviewed and NPA letters were issued. ATF collected \$98,422 from two DSPs but said other DSPs provided adequate proof of export.	We obtained a schedule that showed ATF issued NPA letters to 13 DSPs involving \$88 million in potential tax liability. We did not find documentation to support review or additional documentation for the other shipments.
6. The ATF Director should identify ways to change the current tax-free export procedures. ATF needs to explore ways to reduce paper/manual export procedures and automate the process. The process should include an export tracking system that will age all open shipments so that the 3-year statute of limitation is met.	Open (See tobacco report recommendation for Finding 2-2 on p. 23 of this appendix.)	ATF did not obtain funding needed for an automated system. ATF was unsuccessful in FYs 2001, 2002, and 2003.	We believe TTB should develop an automated system to allow companies to electronically submit export documentation and to allow the bureau to track export documentation status.
7. (a) The ATF Director should assess increasing the use of third-party verifications. 7. (b) The ATF Director should assess the need to standardize the current tax-free export procedures to include specific work steps where third-party verifications are performed.	Closed	ATF developed a letter to send to customers to verify that shipments were received. ATF tried the process for both DSP and tobacco product shipments but discontinued it due to concerns about postage payment.	We believe TTB needs to re-assess the use of third-party verification.

Appendix 2
Summary, Status, Action Taken, And OIG Evaluation Of Prior Report
Recommendations

Report: *The Bureau of Alcohol, Tobacco and Firearms Needs to Improve its Controls Over Tax Free Tobacco Exports* (OIG-01-019, November 13, 2000).

The report contained three findings. First, we estimated that ATF could have assessed at least \$86.9 million of taxes because export shipments either had improper or no export evidence. Second, we found that ATF had not closed claimed export shipments with associated taxes of \$59 million. Third, ATF had not conducted third-party verifications of exported shipments.

For each of the prior audit's recommendations, we assessed the action taken by ATF and evaluated whether the action met the intent of our recommendation.

Recommendation Summary	Status	Action Taken	OIG Evaluation
Finding 1-1. The ATF Director should resolve the problem with the missing records for the 149 tobacco shipments with potential tax liability totaling \$65.6 million, including contacting manufacturers or export warehouse proprietors, if necessary. If the NRC cannot obtain adequate proof of export, action should be taken to collect taxes due.	Closed	ATF reviewed a sample of 82 closed cases and requested copies of missing documents. ATF said export documentation was obtained for all the shipments and no additional taxes were collected.	We selected 34 of the 82 shipments for review. ATF could not locate documentation for five of these shipments. When these records could not be located, we substituted five others. We reviewed the 34 shipments and concluded they had adequate documentation to support the exportations.
Finding 1-2 (first part). The ATF Director should reopen, review, and obtain necessary proof of exportation for 34 tobacco shipments with potential tax liability of \$3.7 million for which no evidence of exportation had been received. If the NRC cannot obtain adequate proof of exportation, action should be taken to collect taxes due.	Closed	ATF reviewed a sample of 11 shipments identified during the original audit as having no proof of exportation. ATF said documentation was received and no additional taxes were collected.	We reviewed the 11 shipments. We found that 9 of the 11 shipments had adequate proof of export, but the other 2 were missing documentation. We believe TTB needs to resolve the other two shipments.

Appendix 2
Summary, Status, Action Taken, And OIG Evaluation Of Prior Report
Recommendations


Recommendation Summary	Status	Action Taken	OIG Evaluation
Finding 1-2 (second part). The ATF Director should reopen, review, and obtain necessary proof of exportation for 124 tobacco shipments with potential tax liability of \$7.9 million for which inadequate evidence of exportation was not available. If the NRC cannot obtain adequate proof of export, action should be taken to collect taxes due.	Closed	ATF reviewed a sample of 17 shipments identified during the original audit as having no proof of exportation. ATF said documentation was received and no additional taxes were collected.	We reviewed the 17 shipments. We found that 16 of the 17 shipments had adequate proof of export, but the remaining shipment was missing documentation. We believe TTB needs to resolve the other shipment.
Finding 1-3. The ATF Director should reassess whether the 192 shipments that did not meet ATF's documentation requirements with potential tax liability of \$9.7 million should also be the subject of an assessment letter.	Closed	ATF selected a sample of 44 export shipments for review and obtained export documentation by contacting the companies.	We reviewed a sample of 16 of the 44 shipments. We determined that the adequate documentation had been obtained for those shipments.
Finding 1-4. The ATF Director should provide Tobacco Unit specialists with the training needed to ensure proper proof of export is received on all tobacco shipments. At a minimum, the training should cover the proper completion of the certificate of receipt on the notice of removal.	Closed	ATF provided the specialists and clerks at NRC with copies of new guidance (a revised ATF Order 5020.8A and Circular 2000-2, issued July 2002, which provides information on exportations and acceptable forms of proof). An NRC supervisor said these documents were discussed at supervisor-employee meetings.	We reviewed the revised guidance. Based on this guidance and discussions ATF indicated occurred at supervisor-employee meetings, we believe ATF has addressed the intent of the recommendation.
Finding 1-5. The ATF Director should require the Tobacco Unit supervisor to periodically review a sample of closed tobacco shipments to ensure the tobacco specialists properly processed the notices of removal.	Closed	ATF said supervisory review changes were made. The supervisor reviewed for one year a random sample of 50 percent of the unit's work. The supervisor also performed an annual review of the specialists' work and reviewed each month's activity to determine if shipments were audited as required. The supervisor's findings were included in the annual performance appraisals. ATF plans to continue this process.	We believe that increased supervisory review addresses the intent of our recommendation.

Appendix 2
Summary, Status, Action Taken, And OIG Evaluation Of Prior Report
Recommendations

Recommendation Summary	Status	Action Taken	OIG Evaluation
Finding 2-1. The ATF Director should follow-up on the 25,548 open tobacco shipments and determine whether tobacco manufacturers and export warehouse proprietors submitted adequate proof of exportation and initiate assessment against those shipments that have not been properly certified.	Closed	ATF said the Tobacco Unit specialists performed a reviewed of the 25,548 open shipments with an aggregate tax value of \$59 million for 1997 and 1998. ATF's Completion Certificate for this recommendation stated that 5,448 shipments remained unresolved. These include 3,200 from 1997 with a potential tax value of about \$3 million, which are beyond the statute of limitations for collection, and 2,248 shipments from 1998, with a tax value of about \$24 million. Documentation was obtained for 1,755 of the 2,248, with a potential tax value of about \$23.98 million, for which NPAs were in process. The remaining 493, with a tax value of \$66,893, remains unresolved.	We judgmentally selected a sample of 23 companies (12 tobacco plants and 11 export warehouses) that had open tobacco shipments during the prior audit. The companies accounted for about \$10.7 million of the \$59 million in potential tax liability. We requested current tracking logs for these companies, which indicate whether the export is open or closed. We compared the current tracking logs with the logs from the prior audit to determine if previously open shipments had been reviewed and closed. We found that ATF had closed shipments representing about \$10.4 million of the \$11 million in our sample. However, due to limited documentation, we could not determine whether ATF fully addressed the intent of the recommendation.
Finding 2-2. The ATF Director should establish controls to ensure Tobacco Unit specialists properly monitor open notices of removal listed in the tracking logs. Consideration should be given to developing an automated tracking system that begins assessment action on all shipments not cleared within 90 days.	Open	ATF's Tobacco Unit requires specialists to maintain by company monthly export transactions the company processed during the month. Tobacco Unit supervisors review these spreadsheets to ensure specialists properly processed notices of removal. Controls include quarterly reports from the supervisor to specialists informing them of dates to conduct reviews, requirement that specialists work one day per week on exports, supervisory review, and quarterly reviews. ATF did not obtain funding for an automated system.	We believe TTB should develop an automated system to allow companies to electronically submit export documentation and to allow the bureau to track export documentation status.

Appendix 2
Summary, Status, Action Taken, And OIG Evaluation Of Prior Report
Recommendations

Recommendation Summary	Status	Action Taken	OIG Evaluation
Finding 3-1. The ATF Director should ensure ATF conducts third-party verifications of tax-free tobacco exports.	Closed	In September 2000, ATF initiated mailing of third-party verification letters. The procedure called for contacting the industry member should a discrepancy be found. Failure to resolve the discrepancy satisfactorily would result in assessment action. Although ATF developed a standard letter, ATF mailed only four letters before terminating the procedure. ATF had received confirmation on two of the four shipments. ATF was concerned about customers mailing letters at their own expense.	We believe TTB needs to revisit this recommendation and consider other options.

	DEPARTMENT OF THE TREASURY	
	ALCOHOL AND TOBACCO TAX AND TRADE BUREAU	
	WASHINGTON, D.C. 20226	
ADMINISTRATOR	JAN 29 2004	810000: AHR 7630
 MEMORANDUM TO: Director, Eastern Field Audit Office Office of Inspector General		
FROM: Administrator		
SUBJECT: Export Document Verification Program		
 This refers to your request of December 2, 2003, for comments on the final audit report, "REVENUE COLLECTION AND INDUSTRY REGULATION: Alcohol and Tobacco Export Controls Strengthened, But More Action Is Needed". We have reviewed the final report and appreciate the opportunity to present the comments that follow.		
The audit was a follow-up to an earlier audit to determine whether the Alcohol and Tobacco Tax and Trade Bureau's (TTB) predecessor agency, the Bureau of Alcohol, Tobacco and Firearms (ATF), had taken corrective action to address recommendations contained in two previously issued reports.		
Finding 1 (Actions Taken To Improve Guidance, Training, and Supervision) determined that although improvements in several areas had been made, it was found that records control and the lack of documentation continued to be a problem. A need to more timely obtain and review documentation supporting exports was also found. As discussed at our meeting of December 2, 2003, since becoming a separate Bureau, TTB has taken a fresh look at export verification and has determined that the best approach to this area would be through a post-audit process. TTB's Tax Audit Division has been tasked with developing new procedures to validate exports through audits of records the producers would be required to maintain.		
Finding 2 (Locating Records Continues To Be A Problem) of the audit found that in certain cases, records were still not available. TTB recognizes that this is a problem resulting from the current tracking system and volume of paperwork received. TTB's new post-audit procedures will require that these records be maintained by the producers and be available to TTB auditors and investigators for review.		

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Director, Eastern Field Audit Office

Finding 3 (Documentation Limited To Support Reviews Of Export Tracking Logs) recommended that TTB continue to request funding for an automated system to allow for the electronic submission and verification of export status. The report acknowledged that ATF was denied funding for this automated system in the last three budget cycles. The need for the submission of supporting export documentation will not exist when TTB implements new procedures which will require producers to maintain the required documentation for review by TTB.

Finding 4 (More Could Have Been Done To Ensure Use Of Third Party Verifications) recommended TTB re-assess the use of third-party verification. We have reviewed this issue and determined that third party verifications would not be beneficial in determining the validity of export documents. Third party verifications with unknown customers in foreign countries would be highly suspect. Additionally, many export shipments are destined for subsidiaries or affiliates of the shipper and the potential exists for completely fictitious consignees created as part of a sophisticated fraud. Lastly, foreign customers are under no obligation to respond to a TTB inquiry and their failure to do so would be highly problematic, as TTB could not use a non-response as a basis for assessment.

In conclusion, it is TTB's intent to proceed with new procedures that would assure the necessary documentation needed to verify exportation would be available on a post-audit basis at the producers' place of business for examination by TTB personnel. If you have any further question, please contact Theresa Glasscock, Chief of Staff, TTB, at (202)927-5000.


Arthur J. Libertucci

Eastern Field Audit Office

Donald P. Benson, Director
Dennis F. Deely, Audit Manager
N. Randy Gettmann, Auditor

Department of the Treasury

Office of Strategic Planning and Evaluations
Office of Accounting and Internal Controls

Alcohol and Tobacco Tax and Trade Bureau

Administrator
Assistant Administrator, Field Operations
Chief, National Revenue Center
Chief of Staff

Office of Management and Budget

OIG Budget Examiner